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Monday, June 22, 1987

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re

ALTO PHOENIX, INC.,

No. 1-87-00850

[Debtor](#) <sup>i</sup>.

### **ORDER ON MOTION FOR RELIEF FROM STAY**

[Creditor](#) <sup>i</sup> John R. Doherty filed the instant motion for relief from the [automatic stay](#) <sup>i</sup> seeking leave to enforce his security interest in the debtor's accounts receivable on the grounds that the debtor has not segregated or accounted for them; Doherty claims the accounts receivable are his cash collateral. The debtor responds by arguing that Doherty has no security interest in receivables other than those existing on the day the security agreement was executed, so that the funds used by the debtor were not cash collateral.

Neither the security agreement nor the financing statement contain an after-acquired property clause. Both merely recite a security interest granted to Doherty "in and to all of the tools, fixtures, equipment, furniture, inventory, supplies, vehicles, receivables, cash and other assets and rights owned by the Debtor ...." There are therefore two issues; whether the parties in fact intended after-acquired receivables to be included and, if they did so intend, whether the security interest was so poorly perfected as to render the security interest junior to the [bankruptcy estate](#) <sup>i</sup>'s interest pursuant to section 544(a) of the [Bankruptcy Code](#) <sup>i</sup>.

### **PROCEDURE**

The validity and extent of a [lien](#) <sup>i</sup> is properly determined by an [adversary proceeding](#) <sup>i</sup> pursuant to Rule 7001(2); the court accordingly does not make a final determination of

validity here. Rather, the court here only makes a determination as to which party is most likely to prevail in such an adversary proceeding, and makes its order accordingly. This order is therefore more in the nature of a preliminary injunction than a final determination of the merits of the parties' positions.

## **INTENT**

The court has no trouble finding that Doherty and the debtor intended that Doherty be granted a floating lien on the debtor's receivables, notwithstanding the glaring lack of an after-acquired property clause in the security agreement. Such an intent can be inferred from the purpose of the loan, which was to supply operating capital rather than purchase money financing (Cf. Raleigh Industries of America, Inc. v. Tassone (1977) 74 Cal.App.3d 692), and the lack of any listing of accounts which would be expected if a construction company were granting an interest only in a fixed set of accounts (Cf. DuBay v. Williams (9th Cir.1969) 417 F.2d 1277, 1285). More importantly, hard evidence of intent is found in a UCC-2 form executed four months after the original UCC-1 was filed. Although the UCC-2 was never filed, its purpose was to release certain items of collateral and not otherwise modify the UCC-1. The UCC-2, signed by the debtor, confirms Doherty's security interest "in all other assets, specifically, but not limited to, the equipment and the accounts receivable of the debtor." This strongly indicates that both parties were not differentiating between receivables existing when the loan was made and after-acquired receivables.


## **LAW**

Having found probable intent to create a security interest in after-acquired receivables, the court finds itself at a crossroad. The court can either follow In re Middle Atlantic Welding Co. (3rd Cir.1974) 503 F.2d 1133, which found no enforceable security interest in after-acquired receivables notwithstanding the intent of the parties to create such an interest, or the court can follow American Employees Ins. Co. v. American Sec. Bank (D.C. Cir.1984) 747 F.2d 1493, which found that because of the changing nature of receivables a security agreement and financing statement need not explicitly have an after-acquired property clause in order to have the lien float. The court does not resolve the conflict between Middle Atlantic and American Employers in a vacuum; it must consult and follow cases decided by the Court of Appeals in this circuit. It appears that in this circuit the philosophy and principles of American Employers is favored over the strict holding of Middle Atlantic.

In Biggins v. Southwest Bank (9th Cir.1973) 490 F.2d 1304, the [trustee](#) in bankruptcy sought to recover as preferences proceeds from a bank's prepetition lien sale of a debtor's automobile inventory. The trustee argued that because the after-acquired property clause in the financing statement was inadequate, the bank had no valid security interest in the automobiles. The court rejected this argument, holding that "the financing statement's purpose is to merely alert the third party as to the need for further investigation, never to provide a comprehensive data bank as to details of prior arrangements." 490 F.2d at 1308. The court found that since the parties clearly intended after-acquired inventory to be covered by the security agreement, and since reasonable inquiry would have uncovered this intent, and since the financing statement was sufficient to require a third party to make an inquiry, that the security interest was valid. Applying the Biggins test to this matter, it seems clear that the mention of accounts receivable in the financing statement was sufficient to require a third party to make further inquiry. The third party would want to know whether the security interest in receivables was a floating interest or an interest in a specific set of accounts; reference to the security agreement would have indicated the former, and consultation with the secured party would have confirmed that intent. Thus, it appears that Doherty has an enforceable security interest in after-acquired receivables notwithstanding his failure to spell

it out in the documents. A review of bankruptcy court decisions supports the court's conclusion here. While the bankruptcy court in In re Young (Bkrtcy.E.D.Pa.1984) 42 B.R. 939, 941, was compelled to follow Middle Atlantic and find no valid interest in after-acquired property, the courts in In re Fricks (Bkrtcy.N.D.Ala.1986) 58 B.R. 883, and In re Gary and Connie Jones Drugs, Inc. (Bkrtcy.D.Kan.1983) 35 B.R. 608, as well as the District Court in In re Fibre Glass Boat Corp. (S.D.Fla.1971) 324 F.Supp. 1054, all found valid interests in after-acquired property notwithstanding the absence of an after-acquired property clause. Those jurisdictions not following Middle Atlantic have no trouble validating such interests where the named collateral by its nature ebbs and flows, so that common sense dictates that the parties must have intended a floating lien. Jones Drugs, supra, at 611.

### **LEGAL CONCLUSION**

The reasoning of the Ninth Circuit in Biggins v. Southwest Bank makes it doubtful that Middle Atlantic is good law in this circuit. Because of the nature of accounts receivable and the lack of any specific accounts in the security agreement, the court finds that the parties probably intended Doherty's security interest to extend to after-acquired receivables. Until and unless the debtor establishes otherwise in an adversary proceeding, all receivables of the debtor existing on the day it filed its [Chapter 11](#)  petition shall be treated as Doherty's cash collateral.

### **ORDER**

No relief from the automatic stay is necessary or appropriate at this time, as this court has full and exclusive jurisdiction over the debtor and its conduct. The debtor is hereby ordered to:

1. Segregate all cash collateral as described in this order; 2. Refrain from using any cash collateral without permission of the court; and 3. Within 15 days after entry of this order, provide an accounting to Doherty of all improperly used cash collateral.

Dated: June 22, 1987

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ALAN JAROSLOVSKY

U.S. [BANKRUPTCY JUDGE](#) 

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